THE FEDERAL FARM LOAN SYSTEM[1]

I

Those who were familiar with the general provisions[2] of the Federal Farm Loan act at the time of its passage were almost unanimous in the opinion that several years must elapse before the machinery authorized by that measure could materially alter the land credit system to which the American farmer and the investing public had become accustomed. Unlike the Federal Reserve act, which had been designed to bring about desirable reforms in the commercial banking system with as little disturbance to the banking institutions of the country as possible, the Federal Farm Loan act boldly set aside American traditions in the farm mortgage business and sought not only to establish a variety of entirely new land credit institutions but also to prescribe new methods in the making of farm loans that would compare favorably with European precedents. In spirit the act was revolutionary—its authors were convinced that American methods were not worth saving; and the machinery for which it provided was greatly complicated by the fact that it did not represent the ideas of any single group of reformers. One group had been strongly in favor of direct government loans, another of coöperation, and still another of private enterprise as the basis of land credit reform. The necessity of reconciling these varied interests in a single measure could hardly be expected to make for a system that would be simple, easily administered, or immediately popular.

The preliminary organization of the system required almost a year's time. The first important task to be undertaken by the newly created Federal Farm Loan Board was the apportionment of the country into twelve districts and the establishment in each district of a federal land bank. The act had provided that these districts were to be apportioned "with due regard to the farm loan needs of the country," and that no district should contain a

[1] The writer is indebted to Mr. Herbert Quick of the Federal Farm Loan Board for most of the specific facts bearing on the progress of the system. Unless otherwise indicated, the statistical data in this article have been obtained from that source.

[2] For a critical discussion of the provisions of this act, see article entitled "The Federal Farm Loan Act," AMERICAN ECONOMIC REVIEW, vol. VI (December, 1916), pp. 770-789.

fractional part of any state. It was the judgment of the board that the fairest and most satisfactory way of determining the farm loan needs of the country would be through actual conference with farmers, bankers, and students of agricultural conditions. Accordingly, arrangements were made for a series of public hearings. These hearings, held in forty-four states and extending over a period of about four months, did much to acquaint the farmers with the intricacies of the new legislation.

With regard to the considerations which actually governed the board in determining the size and boundaries of federal land bank districts,[3] some attention was given to the census data pertaining to the area and value of farm land, the extent of farm mortgage indebtedness, the character and value of farm products, and the proportion of rural to total population. In addition, there were important considerations as to whether the district in question was well developed agriculturally, whether it was a one-crop district, and whether the prevailing rate of interest was such that it would lead to a rapid shifting of outstanding mortgage loans from private institutions to the federal land banks. But judging from the plan of apportionment finally adopted, it is obvious that it was the board's policy to combine into one district, wherever possible, those states whose farm loan securities were not well known with states whose farm mortgage securities stood high in the investment market. For instance Arkansas, Missouri, and Illinois, were combined to form one district; Wyoming, South Dakota, Nebraska, and Iowa, to form another; Kentucky and Tennessee were merged with Ohio and Indiana; New Mexico and Oklahoma with Kansas and Colorado. This plan of delimitation, so far as it could be carried out, was intended to equalize the security of land mortgage credit throughout the twelve districts

[3] On December 27, 1916, the Secretary of the Treasury announced the selection of the following districts by numbers and the cities in which federal land banks would be established: (1) Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, and New Jersey, at Springfield; (2) Pennsylvania, Maryland, Delaware, Virginia, West Virginia, and District of Columbia, at Baltimore; (3) North Carolina, South Carolina, Georgia, and Florida, at Columbia; (4) Ohio, Indiana, Kentucky, and Tennessee, at Louisville; (5) Alabama, Mississippi, and Louisiana, at New Orleans; (6) Illinois, Missouri, and Arkansas, at St. Louis; (7) Michigan, Wisconsin, Minnesota, and North Dakota, at St. Paul; (8) Iowa, Nebraska, South Dakota, and Wyoming, at Omaha; (9) Oklahoma, Kansas, Colorado, and New Mexico, at Wichita; (10) Texas, at Houston; (11) California, Nevada, Utah, and Arizona, at Berkeley; (12) Washington, Oregon, Idaho, and Montana, at Spokane.

and, in accord with the spirit of the act, to insure the complete mobility of capital seeking farm mortgage investment.

The selection of the sites for the twelve federal land banks naturally followed the delimitation of the land bank districts. In the settlement of this problem, which was aggravated by the fact that over one hundred cities had presented their claims for selection, it was felt that some preference should be shown to those cities where there was already an aroused interest in agriculture rather than to the great commercial centers. In district 1, for instance, the award was made to Springfield rather than to Boston; and in district 11 to Berkeley rather than to San Francisco. In some cases it was possible to select a city which represented the approximate geographical center of the district; in others, to make the award to cities which, by a small margin, had failed in their efforts to gain commercial recognition from the Reserve Bank Organization Committee. This was notably true in districts 2, 5, and 7. But on the whole, the claims of the great commercial and distributing centers were unfavorably regarded. St. Louis was the only city having a federal reserve bank to be chosen as the site of a federal land bank.

The organization of the land banks proceeded slowly. It was not until March 1, 1917, that the first charter was granted. Meanwhile, the board had been confronted with the task of choosing a registrar and five directors for each bank. In the selection of the directors it was inevitable that mistakes would be made, because there was no way of knowing whether men experienced in the management of other financial undertakings could adapt themselves to the work of entirely new institutions. In those districts where it was mathematically possible, the board attempted to give each state one representative on the directorate of the land bank in the hope that such representation would prove beneficial to the management. Moreover, if loans were refused in a particular state, or if a low valuation were placed upon certain kinds of land, the residents of that state would have no grounds for complaining that they had not been properly represented. It subsequently appeared that some of the directors had misconceived their duties, believing that their primary function was to serve the interests of their own state. In other cases there were personal differences which aroused a good deal of public comment. In two of the land banks there was a distinct lack of harmony in the management, and the board was obliged to make new selections.

As was expected, most of the stock of the land banks was subscribed for by the Secretary of the Treasury on behalf of the United States. While the act had provided that subscriptions should first be received from individuals, firms, corporations, and state governments, the board made no attempt to encourage such subscriptions. In fact there was little in the investment possibilities of the land bank shares that would appeal to private investors. The payment of dividends the first year was clearly out of question; in the hands of private individuals the shares carried no voting power; it seemed improbable, moreover, that dividends in excess of 6 per cent would ever be paid, because the banks were established for the express purpose of reducing interest rates to farmers; finally, the law provided for the gradual retirement at par of the original capital stock of a land bank after the subscriptions by national farm loan associations in that district had amounted to $750,000. The stock was made available to the public January 10, 1917, for a period of thirty days. The total subscription which the Secretary of the Treasury was called upon to make on behalf of the government amounted to $8,891,270.[4]

II

The land bank organization was merely the superstructure of the new system. The twelve banks were not intended to deal directly with individual farmers but with intermediary institutions. Borrowers desiring long-term loans amounting in the aggregate to at least $20,000 might organize national farm loan associations which would deal with the land bank of the district; or, if within one year after the passage of the act no such associations had been formed in a given locality and were not likely to be formed, the board might appoint banks, trust companies, mortgage companies, or savings institutions incorporated under state laws, as agents through which a land bank would make long-term loans subject to the same general conditions as if they were made through national farm loan associations. It was clearly the in-

[4] The government's share of the $750,000 capital stock of each bank was as follows:

Springfield	$739,925	St. Paul	$744,740
Baltimore	741,485	Omaha	710,670
Columbia	750,000	Wichita	744,165
Louisville	742,265	Houston	741,235
New Orleans	745,730	Berkeley	744,010
St. Louis	742,075	Spokane	744,970

tention of Congress to encourage the formation of borrowers' associations, but the way was left open to utilize, if necessary, some of the institutions already in existence.

The lending activities of the federal land banks necessarily waited upon the formation of national farm loan associations. Here again the organization process was slow. In addition to the natural difficulties that have always attended the formation of coöperative associations among farmers accustomed to a highly individualistic régime, there were technical difficulties to be overcome—difficulties growing out of the administration of a land credit system which had no American precedent. Scant attention was given by the board to ways and means of overcoming the first difficulty, except to point out the value and magic of coöperation. Inasmuch as the act had virtually proclaimed the necessity of organizing farm loan associations before loans could be granted, the board fell to the task of educating the farmer to an understanding of the proper method of organization, the advantages of long-term loans repayable by amortization, and the economy of converting old mortgages into new ones bearing a lower rate of interest. The campaign of education was conducted through the public press, popular magazines, agricultural journals, the Department of Agriculture, and the publications of the Farm Loan Bureau.

The second set of difficulties required the closest attention of the board. Owing to the indefinite character of many of the provisions in the act, and the broad discretionary powers conferred upon the board, there were numerous perplexing questions to be settled with reference to the most desirable size of an association—the number of members, the amount of loans, and the extent of territory covered; the compensation to be allowed the secretary-treasurer and the members of the local loan committee; the charges for appraisal and the determination of title. In addition, there were questions as to what borrowers were eligible, the purposes for which loans might be made, the kind of land which might be accepted as security, and the valuation that should be placed upon certain classes of land. Among other things the board ruled that an actual farmer is one who conducts the farm and directs its entire operation, with or without hired labor, "but that he need not necessarily reside upon the farm mortgaged"; that "equipment" (one of the purposes for which loans were authorized) includes the "improvements needed in the conduct of a farm to

facilitate its operation, including teams as well as machinery, tools and the like"; that "improvements" include "anything in the form of a beneficial structure"; and that it is unnecessary for borrowers to cultivate all of the land mortgaged.[5]

One other important question had to be decided before farm loan associations could begin their operations, namely, whether the laws of the particular state relating to foreclosure, homestead exemption, the conveying and recording of land titles, etc., were such as to afford sufficient protection to the holders of first mortgages. Investigation showed that the laws of Louisiana and Texas were not wholly satisfactory.[6] In the former state the board refused to sanction loans until the state law had been amended to remove the lien of the widow's dowry upon the lands of decedents. This amendment was promptly authorized by a special session of the legislature. In Texas, the law exempting homesteads from execution and mortgage was unfavorably regarded, but it was not found necessary to refuse loans altogether. In spite of the homestead exemption the federal land bank at Houston has been able to make a fairly large volume of loans. The law still exists (December 1, 1918) and works greatly to the disadvantage of some farmers.

The first charter was granted to a national farm loan association March 27, 1917. Since that time there has been a steady increase in the number of associations formed and the volume of loans granted. The general progress of this part of the system during the first year and a half is shown in the following table:

[5] *First Annual Report of the Federal Farm Loan Board,* 1917, p. 15.

[6] In order to relieve the distress growing out of a disastrous crop season, the legislature of North Dakota passed a law January 30, 1918, authorizing counties to issue bonds and make loans to farmers for the purpose of buying cattle feed and seed wheat. Among other things it was provided that the lien of such loans should have precedence over all obligations which borrowers might subsequently incur. The effect of this law was to make it impossible for the federal land bank at St. Paul to continue the granting of loans, within the state, that would be or would remain first liens. This condition of affairs lasted for more than two months. Finally, a plan was adopted under which any farmer wishing to borrow from the federal land bank might give a surety bond protecting the bank against the making or enforcement of a lien under the "seed and feed" law. This arrangement seemed to meet the satisfaction of all parties, and the activities of the federal land bank were resumed in that state.

District	Associations chartered to Nov. 30, 1917[7]	Loans closed to Nov. 30, 1917	Associations in existence Nov. 1, 1918[7]	Loans from organization to Nov. 1, 1918		
				Appl'd for[8]	Approved	Closed
1. Springfield ..	55	$708,455	111	$9,593,194	$7,111,195	$5,482,875
2. Baltimore ..	77	1,599,900	129	9,545,672	7,591,865	5,441,950
3. Columbia ...	157	918,345	318	22,254,446	11,553,654	6,932,820
4. Louisville ...	194	1,782,300	265	19,713,829	13,962,100	8,897,900
5. New Orleans	168	1,634,335	304	23,032,448	14,312,925	10,043,615
6. St. Louis	140	1,254,470	319	15,879,095	12,947,840	9,455,077
7. St. Paul	126	4,418,100	416	33,163,700	22,950,350	19,773,300
8. Omaha	79	1,787,490	265	25,197,870	20,767,740	15,642,740
9. Wichita	344	7,390,900	381	21,644,651	17,349,500	15,017,600
10. Houston	153	1,145,345	275	26,718,019	26,366,135	12,528,379
11. Berkeley	87	1,818,400	154	13,401,306	10,558,000	8,502,000
12. Spokane	259	5,366,615	421	45,251,882	29,225,120	21,659,900
Total	1,839	$29,824,655	3,358	$265,396,112	$194,696,424	$139,378,156

[7] Does not include charters cancelled. Of these there have been sixty-nine, forty-six in the Wichita district alone.
[8] Does not include cancelled and rejected applications.

In view of the difficulties attending the formation of national farm loan associations, the system has made remarkable progress. During the month of October, 1918, loans to the amount of $7,580,736 were made to 3,075 farmers, and this represents approximately the monthly progress of the system thus far. On November 1 there were 3,358 associations in operation; 61,174 individual loans amounting in the aggregate to $139,378,156 had been made on land mortgage security. While to some this record of accomplishments may seem disappointing—when account is taken of the total amount of mortgage indebtedness in the United States, the period of time during which the system has been in operation, and the public enthusiasm which the new legislation aroused—it must be noted that the work of organizing farm loan associations has only begun, that those already in existence may be expected to add materially to the number of their members, and that in spite of numerous obstacles yet to be overcome the present rate of progress is likely to continue.

It now seems clear, however, that the act provided for more land bank districts than were needed or desirable. Ten districts would have been sufficient. Districts 1 and 2 might well have been combined as it is difficult to see how the Springfield or Balti-

more banks can be profitably operated without the continued use of government capital. Likewise, the small volume of loans applied for in the St. Louis and Berkeley districts would suggest the desirability of a smaller number of districts and a readjustment of the boundary lines. But inequalities in the apportionment of the districts were inevitable; and it is improbable that important changes will be made. For, while the act authorized the board in its discretion to readjust the boundary lines, it definitely fixed the number of land bank districts.

It is also clear that the greatest demand for farm loans under the new system comes from the West and South—the comparatively new farming sections where high interest rates have obtained. At present, the St. Paul and Spokane districts, embracing the Northwestern States, lead all others both in the number of associations formed and the volume of loans applied for. Excluding Texas, which is a district by itself, more associations have been formed in North Dakota than in any other state, and Washington is a close second. The popularity of the farm loan association in communities where interest rates have been high is further evidenced by the fact that in district 6, comprising Illinois, Missouri, and Arkansas, the demand for loans and the number of associations formed is far greater in Arkansas than in Missouri or Illinois. On November 1, 1918, the number of associations operating in these states was 132, 112, and 75 respectively.

That the number of associations from one state to another should vary directly with the rate of interest on private capital and inversely with the extent to which the coöperative spirit has been manifest is, at first glance, paradoxical. Certainly the farmers of the West are the least coöperative at heart. In the past they have shown a decided preference for dealing with institutions conducted for profit. Had it been possible for them to share in the benefits of the new legislation by borrowing from established institutions at a rate of interest almost as low as that accorded to the members of farm loan associations, it is doubtful whether many associations would have been formed. But no such alternative materialized, first because of the little use that was made of the section in the act providing for the appointment of agents. Up to November 1, 1918, only seven agents had been appointed, and all of these were in the St. Paul district. Their total loans amounted to $302,900.

Many of those who at the time of the passage of the act recog-

nized the difficulties that would attend the organization and management of farm loan associations, gave their undivided support to the measure on the ground that the section providing for the appointment of agents was, after all, the most promising feature of the new legislation; that whether or no other sources of credit materialized, land bank agents might be depended upon to fulfil the purpose for which the new system was established.

The small use which has been made of these lending agencies thus far is due to a combination of causes. In the first place, there were administrative difficulties growing out of the law itself. The borrower was required to contribute 5 per cent of the amount of his loan to the stock of a federal land bank, and the commission paid by the land bank to an agent was to be deducted from dividends on the borrower's stock. Since the largest annual commission allowed by the law to an agent was one-half per cent of the unpaid principal of a loan, and dividends are not being paid on land bank stock, it is difficult to understand how this section can be construed so as to permit of its administration. Even if the land banks were paying dividends of 8 per cent—and that seems to be beyond all range of possibility—how could the commission charge on a $1,000 loan be deducted? It is conceivable, of course, that a land bank might not be willing to pay the maximum commission, but would banks and mortgage companies serving as agents be willing to endorse the loans they make for an annual commission of less than one-half per cent? At present there is a margin of only one-half per cent between the borrower's rate of interest and the rate paid on federal farm loan bonds; and if a land bank were to pay the maximum commission charge, it would be lending the proceeds of its bond sales at a decided loss.

In view of these difficulties and of the further fact that agents may make loans only so long as the district in which they operate is inadequately served by farm loan associations, there is really no incentive for banks and mortgage companies to serve in the capacity of agents, nor can their service be anything but a source of annoyance to the administrators of the law. These defects in the act are clearly recognized by the members of the board when they "deem it unlikely that general use will be made or can be made of the section in its present form."[9]

III

Quite another set of problems confronted the board when the land banks were called upon to make loans. Chief among these

[9] *First Annual Report*, p. 24.

problems was that of keeping the banks supplied with a continuous flow of loanable funds. In providing the machinery for this purpose the act had assumed that as a bank invested its capital in mortgage loans it would pledge the mortgages as security for a bond issue, sell the bonds, and thereby maintain a continuous supply of working capital. This assumption, however, overlooked the fact that the mere mechanical process of issuing bonds involved delay, that a large portion of a bank's capital would be locked up in farm loans at a time when the mortgages were not yet available for bond issues, and that in the case of some of the land banks all of the original capital might be exhausted before bonds could possibly be issued. Moreover, it was not fully realized that these bonds would be a new type of security to American investors, and that in spite of their attractive investment qualities they might not appeal to conservative investment classes.

In order that the land banks might have the most immediate and dependable market for their bonds, the board sought the cooperation of a group of bond houses.[10] These houses agreed to associate with themselves bond dealers in every federal land bank district; to purchase 40 per cent of the bonds issued under the first agreement; and to retail them at a price of 101⅛. The rate of interest borne by the bonds was 4½ per cent. They were drawn for a term of twenty years, and might be called after the expiration of five years. Under this agreement the syndicate purchased approximately $25,000,000 of the bonds.

The establishment of an interest rate of 4½ per cent on federal farm loan bonds made it necessary that the land banks lend at not less than 5 nor more than 5½ per cent. It was known that even if loans were made at the maximum rate, the full margin of 1 per cent would not enable the land banks to meet their expenses the first year. Nevertheless the borrower's rate was fixed at 5 per cent. At the same time the board strongly advised that farmers take out their mortgage loans for a period of thirty-six years.

A good deal of hostile criticism was aroused in certain quarters[11] on account of the wide difference in the terms for which bonds and mortgages were to run. It was claimed that, inasmuch as bonds and mortgages were improperly matched, the board was leading the land banks to financial ruin, that when the bonds ma-

[10] The syndicate was composed of Alexander Brown and Sons of Baltimore; Brown Brothers and Company of Philadelphia; Harris, Forbes and Company of New York; and Lee, Higginson and Company of Boston.

tured the banks would be unable to meet their obligations because of the unpaid principal on their loans. But such criticism could scarcely be made in good faith by any one familiar with the activities of foreign rural credit associations. It is no violation of sound land credit principles to make loans for one term of years and to issue bonds for another so long as the volume of outstanding bonds does not exceed the unpaid principal of the loans. Certainly in the present case there was ample justification for the board's policy. If, at the outset, it was expedient to fix a low rate of interest on loans, it was also desirable that the yearly charge for amortization be small. Otherwise it might not have seemed advantageous to borrowers in the older agricultural sections, where the yearly cost of borrowing is already low, to fall in line with the spirit of the new system and organize associations. From the point of view of the investor the short-term bond was preferable to a bond maturing in thirty-six years because of the novel character of the investment. And on the administrative side there was the hope that most of the 4½ per cent bonds might be called in before maturity and converted into 4 or 3½ per cent bonds. Finally, if the unexpected should occur, and a large number of borrowers allowed their loans to run until maturity, the unpaid portion of their principal at the end of twenty years would still be available as security for new bonds, bearing a lower rate of interest, from the proceeds of which all obligations could be promptly met.

The entrance of the United States into the European conflict greatly affected the board's policy as to interest rates on bonds and mortgages. Between the first and second Liberty Loan issues, no difficulty was experienced in marketing nearly $30,000,000 of farm loan bonds at a premium. But the absorption by the government of nearly six billion dollars of capital within a period of six months and the rapid rise in interest rates, made it evident that even with a reduction in the premium on farm loan bonds they could not be marketed either in the amount or with the promptness that the farm loan situation required. For, in addition to the consideration that the normal farm loan needs of the country must be supplied, there was the fact that war prices

[11] See especially the criticism by Myron T. Herrick in *Journal of the American Bankers Association,* vol. X (March, 1918), pp. 641-643; also of R. Ingalls, *Congressional Record,* vol. 56 (April 6, 1918), pp. 5127-5131.

had greatly stimulated the demand for farm loans, and that everywhere farmers were being urged to increase their efforts.

In the face of the nation-wide propaganda to further the production of foodstuffs, the rise in the rate of interest on highly marketable securities caused some withdrawal of private capital from the farm mortgage field. Except in those cases where motives of patriotism forbade "profiteering" in interest rates, the renewal of maturing farm loans at the old rate of interest was not an easy matter. In short, the difficulties that beset borrowers in getting accommodation from the old established institutions whether for the renewal of maturing loans or for the purpose of extending their agricultural operations, created a distinct demand for the services of the federal land banks which were in no position to furnish the funds required.

The first step taken by the board in dealing with this problem was to recommend to the several banks that the interest rate on mortgages be increased to 5½ per cent. This rate became effective December 6, 1917. The second step was to submit to Congress an amendment to the law authorizing the Secretary of the Treasury to purchase farm loan bonds at par and accrued interest to an amount not exceeding $100,000,000 in each of the fiscal years ending June 30, 1918, and June 30, 1919, to be subject to redemption or resale by the land banks at the same price. This amendment was approved January 18, 1918. Finally, in May the interest rate on farm loan bonds was increased to 5 per cent.

The necessity of calling upon the Federal Treasury to purchase "instrumentalities of the Government of the United States," was especially obnoxious to those who had been hostile toward the farm loan system from the time of its inception. But in view of the peculiar situation created by the war, there appears to have been abundant justification for this temporary expedient. Not only did it enable the land banks to continue the granting of loans to an essential war industry, but it accomplished this purpose without interfering in any way with the sale of Liberty bonds. Doubtless the public offering of tax-exempt farm loan bonds bearing high interest rates at a time when Liberty bonds were being subjected to heavier taxes, would have caused no little embarrassment to the Secretary of the Treasury.

On December 1, 1918, the total volume of federal farm loan bonds outstanding amounted to $140,500,000.[12] Under the authority granted by the amendment of January 18, the Treasury

Land bank	Bearing 4½ per cent	Bearing 5 per cent	Total
Springfield	$1,750,000	$3,250,000	$5,000,000
Baltimore	2,750,000	2,500,000	5,250,000
Columbia	3,000,000	3,500,000	6,500,000
Louisville	4,750,000	4,250,000	9,000,000
New Orleans	5,750,000	5,000,000	10,750,000
St. Louis	4,500,000	6,500,000	11,000,000
St. Paul	14,500,000	5,750,000	20,250,000
Omaha	11,000,000	3,250,000	14,250,000
Wichita	10,750,000	3,500,000	14,250,000
Houston	7,250,000	5,750,000	13,000,000
Berkeley	5,250,000	2,750,000	8,000,000
Spokane	13,750,000	9,500,000	23,250,000
Total	$85,000,000	$55,500,000	$140,500,000

had purchased altogether $67,660,000 of the bonds, and the land banks had repurchased and sold at a substantial premium $11,-690,000 of the 5 per cent bonds dated May 1, 1918. The remainder, amounting to $55,970,000 and bearing 4½ per cent represented the net total of the bonds purchased and held by the Secretary of the Treasury.

Another provision in the amendment of January 18 was concerned with the internal organization of the land banks. The original act provided that as soon as the subscriptions of national farm loan associations to the stock of any land bank had reached the sum of $100,000, that is, when a land bank had made loans to the amount of $2,000,000, the number of land bank directors would be increased from five to nine. Six of these, known as "local directors" were to be chosen by and be representative of national farm loan associations. It provided, moreover, that after a land bank had received stock subscriptions of $750,000 from farm loan associations, it should begin the retirement of the shares subscribed for by the government and the public by applying semi-annually 25 per cent of all sums thereafter subscribed to the retirement of the original stock.

In accordance with this second provision, the Spokane and St. Paul banks retired government stock during the month of November, 1918, to the amount of $74,583 and $52,131 respectively. During the same month the subscriptions to the stock of the

[12] The total volume of 4½ and 5 per cent bonds outstanding in the name of each land bank was as follows:

Omaha and Wichita banks also exceeded $750,000, and these banks are therefore expected to retire a portion of their government stock in May, 1919.[13] In spite of this progress, however, none of the land banks has been organized on a permanent basis. In view of the fact that the government must for several years continue to be a majority stockholder in the banks, that the banks themselves may be employed as financial agents of the government, and that the Secretary of the Treasury was required to purchase their bonds, it was the judgment of the board that the government should name a majority of the land bank directors so long as it continued to be the majority stockholder. Accordingly, the amendment providing for the purchase of farm loan bonds by the Secretary of the Treasury also provided that the temporary organization of any federal land bank should be continued so long as any farm loan bonds were held by the Treasury, and until the subscriptions to stock by national farm loan associations equalled the amount of stock held by the government.

Thus far none of the land banks has paid dividends, but four of them, namely, Omaha, St. Paul, Wichita, and Spokane, are now accumulating surpluses and it is anticipated that their earnings will soon warrant dividend payments. The business of the other banks has been comparatively small, too small to overcome the impairment of capital which, as a matter of course, began as soon as they were organized. Handicapped by their inability to make loans through agents, they have been obliged to wait upon the formation of national farm loan associations. Moreover, their expenses have proved to be rather burdensome on account of the large number of small borrowers and the fact that the costs of appraisement and determination of title are practically the same whether a loan is large or small. While a portion of this expense has been shifted to the borrower, there remains a fixed charge upon the land banks which cannot be materially reduced so long as the average size of loans is small. With a view to increasing the net earning power of the less prosperous banks, the board has suggested to Congress that the maximum loan authorized by the act be increased from $10,000 to $25,000.[14] At the same time it calls attention to the fact that the question of dividends is relatively unimportant and that the lack of dividends on stock

[13] *Annual Report of the Secretary of the Treasury,* 1918, p. 104.
[14] *First Annual Report,* p. 24.

held by national farm loan associations is fully made up to borrowers in the form of a low interest rate on their loans.

IV

In order to protect the farm mortgage companies already in existence and to satisfy those who favored private enterprise as the proper basis of land credit reform, the act provided for the voluntary incorporation of joint stock land banks under a federal charter. The status of these banks in the new system was peculiar. While they were in no way dependent upon the formation of national farm loan associations, and were free from many of the restrictions imposed upon federal land banks, a joint stock bank could make mortgage loans in only two states contiguous to one another, and could issue bonds only up to fifteen times its capital stock and surplus. At the same time these banks were dependent upon the services of a federal land bank appraiser and the farm loan registrar, and were subject to supervision by the Federal Farm Loan Board. In providing for two distinct types of bond issuing banks, the act was in reality a combination of two distinct laws; but the section dealing with joint stock banks was carelessly framed and so involved with other sections that it was exceedingly ambiguous and, on some points, even contradictory.[15]

It was almost a year after the passage of the act before any joint stock land banks were organized. The law itself was responsible for this delay, first, because it did not meet with the approval of farm mortgage bankers, and secondly, because it was impossible for a joint stock bank to begin active operations until the federal land banks had been firmly established. In the South and West, however, a number of "rural credit associations" came into existence almost immediately after the act was passed. The representation was made that these associations would subsequently be recognized under a federal charter. Liberal fees were paid to those who sold the stock, and liberal promises were made to farmers who subscribed for the shares. Many of these concerns were clearly fraudulent and the board was obliged to intervene for the protection of the stockholders. One of the first rulings adopted by the board was that no charter would be granted to any joint stock land bank in the organization of which there had been any expense for promotion.

Although a few joint stock banks were organized almost im-

[15] See AMERICAN ECONOMIC REVIEW, vol. VI, p. 727, footnote 30.

mediately after the federal land banks were ready to begin their operations, progress thus far has been slow. Up to November 1, 1918, nine such banks had been formed, and five of these had issued bonds amounting in the aggregate to $6,875,000. The significant facts relative to the organization and operation of these banks are shown in the following table:

Name of bank[16]	Date of organization	Location of principal office	Territory	Capital	Bonds	Interest rate on bonds
						Per cent
Iowa	Apr. 24, 1917	Sioux City, Iowa	Iowa, S. Dak.	$1,125,000	$75,000	5
Virginian...	May 7, 1917	Charleston, W. Va.	Ohio, W. Va.	250,000	800,000	5
Fletcher	June 28, 1917	Indianapolis, Ind.	Ind., Ill.	250,000	1,400,000 800,000	5 4½
First	July 25, 1917	Chicago, Ill.	Ill., Iowa	375,000	3,300,000	5
Liberty	Jan. 9, 1918	Salina, Kans.	Kans., Mo.	250,000	500,000	5
Mississippi..	June 22, 1918	Memphis, Tenn.	Tenn., Miss.	250,000		
Arkansas....	June 22, 1918	Memphis, Tenn.	Tenn., Ark.	250,000		
Lincoln.....	July 12, 1918	Lincoln, Neb.	Neb., Iowa	250,000		
Bankers.....	Sept. 6, 1918	Milwaukee, Wis.	Wis., Minn.	250,000		

[16] The name as indicated must be followed in each case by "joint stock land bank" in conformity with a ruling of the board.

Another fact of significance is that only four of these banks were engaged in the business of negotiating farm mortgages prior to the date of their organization as federal corporations, and two of these, located at Memphis, are operated by the same group of mortgage bankers. Manifestly, farm mortgage companies have been reluctant to change their form of organization or the method of conducting their business—and for good cause. The larger companies have perfected an organization extending over several states. The territory in which they operate has been carefully selected, they have the goodwill of a large and dependable clientele, and with a very small amount of capital they can conduct a large and fairly profitable business. Moreover, their mortgages can be sold without recourse and they are under no obligation to limit the volume of their loans. Finally, the business of these companies has hardly been affected by the operations of the federal land banks. The activities of the farm mortgage companies have been

confined for the most part to the states that rank first in agricultural development, while the business of the federal land banks has come largely from the newer agricultural sections. Where these two systems are thrown into competition with one another, the advantages offered by the federal land banks in the form of a lower rate of interest may be offset by the fact that the farmer who borrows from a mortgage company knows in advance the approximate cost of his loan; he can repay his principal in whole or in part before the expiration of five years; and the period of time elapsing between the application for and the closing of a loan is, in most cases, exceedingly short. It could not, therefore, be expected that a large number of companies engaged in making land mortgage loans would reorganize under a federal charter.

It is not to be inferred, however, that farm mortgage bankers have been indifferent toward the new legislation merely because they have not yet felt the competition of the federal land banks. On the contrary, they have been thoroughly aroused by the steady growth in the number of farm loan associations. And, although discounting the ultimate success of these potential competitors, they are endeavoring to secure certain changes in the law in order that they might be able, should the necessity arise, to come in under the new system and compete with the federal land banks on more advantageous terms. The specific amendments which they propose were the outgrowth of a series of conferences, beginning in October, 1917, and lasting until January 5, 1918, between a special committee of the Farm Mortgage Bankers Association and the Federal Farm Loan Board. These amendments, if approved, would permit a joint stock land bank: (1) to make mortgage loans in all parts of the continental United States; (2) to issue farm loan bonds up to twenty times its capital and surplus; (3) to make loans at a maximum rate of $6\frac{1}{2}$ per cent; (4) to sell mortgages without recourse when not to be used as security for bond issues; (5) to make short-time loans and single payment loans or loans payable in instalments; (6) to invest a portion of its funds in municipal bonds and other securities to be approved by the board; (7) to substitute the word "national" in place of the words "joint stock" in the corporate name; and (8) to go into voluntary liquidation. In addition, it is proposed that the provisions of the law relating to joint stock land banks be brought together into one complete section so that they may be entirely independent of the sections pertaining to federal land banks.

To the first three of these proposed amendments the board has offered no objection.[17] On the other proposed changes the board has been unwilling to express an opinion in advance of a request from Congress. It would seem only reasonable, however, that farm mortgage companies reorganized as joint stock land banks be allowed these additional privileges. In the early period of their existence, the privilege of selling mortgages without recourse, and of making loans payable in lump sum, would enable them to retain those clients who prefer the old farm mortgage methods. The power to make short-time loans and to invest in certain classes of municipal securities would insure a maximum earning power for funds that might otherwise be idle. The argument that the words "joint stock" are of foreign origin and convey no definite meaning to American investors is well taken. In proposing that the word "national" be substituted for "joint stock" in the corporate name, and that such banks be allowed to go into voluntary liquidation, the farm mortgage companies are merely asking to be put upon an equal plane with national banks. Finally, the provisions of the law dealing with joint stock banks should be brought together and rewritten, even at the risk of repetition, in order to clarify the legal status of these institutions.

If these changes in the law are approved—and a bill[18] embodying the proposed amendments is soon to be introduced in Congress—the opportunity for private enterprise in the new system will at once be greatly extended. And, unless the country is definitely committed to a policy of government loans, this opportunity should be granted. Experience has shown that private enterprise can be depended upon to mobilize capital and reduce interest rates if given the proper machinery, and that institutions conducted for profit can operate successfully in competition with state-aided ventures. It is worth noting in this connection that on November 1, 1918, the Virginian Joint Stock Land Bank, operating in Ohio and West Virginia, had issued bonds to the amount of $800,000, and that the total volume of mortgage loans made by the federal land banks in the same territory was $1,396,100. On the same date, the Fletcher Joint Stock Land Bank had issued bonds to the amount of $2,200,000 on the security of mortgage loans made in Indiana and Illinois, and in these states the loans

17 See *First Annual Report*, p. 23.

18 See *Bulletin of the Farm Mortgage Bankers Association*, vol. IV (July, 1918), pp. 17-25.

of federal land banks had amounted to $6,306,960. When account is taken of the prejudicial character of the law relating to private enterprise, the fact that federal land banks are much larger institutions than any of the joint stock banks yet formed, and that their interest rate to borrowers is somewhat lower, the progress of the joint stock land banks thus far is all that could be expected. If the amendments now proposed by the farm mortgage bankers are approved, it is not unlikely that joint stock land banks would conduct most of the farm mortgage business of the Middle West.

V

The purpose of the Federal Farm Loan act was clearly twofold: first, to improve the method of making loans; second, to reduce to approximate equality throughout the United States the cost of borrowing on farm mortgage security. Some of the outstanding qualitative results of this twofold program may now be noted.

It is unnecessary to point out that the system has already demonstrated the superiority of long-term loans repayable by amortization, and the advantages of mobilizing capital through the sale of bonds issued on the collective security of farm mortgages. Through the medium of federal farm loan bonds capital has been made to move from the investment centers of the country to the farm mortgage field with less expense to the borrowers than ever before. In the old agricultural states, the utilization of this machinery has not been attended with great economies, but in those sections where interest rates were formerly 8 to 10 per cent, the cost of borrowing has been materially reduced and the demand for loans greatly stimulated.

That the federal land banks have found their most promising field for operation in those states which under the old régime were not favorably regarded by the private capitalist, is shown by the fact that of the total loans they had made on November 1, 1918, 32.5 per cent had been made in the Southern States, including the South Atlantic division, where the farm mortgage indebtedness is 16.1[19] per cent of that of the entire country. In the Mountain States the corresponding figures were 12.7 and 2.8 per cent; in

[19] Estimates of the Department of Agriculture for 1915 based on the thirteenth census figures. See *Hearings before the Subcommittee of the Joint Committee on Rural Credits* (64 Cong., 1 Sess.), p. 107.

the Pacific Coast division, 12.7 and 5.6 per cent; in the West North Central States, 29.05 and 38.2 per cent; in the East North Central States, 8.4 and 26.2 per cent; and in the New England and Middle Atlantic divisions combined, 4.5 and 10.9 per cent. While the steady flow of capital[20] to the West and South should greatly stimulate agricultural progress, there is an apparent danger that in making too large a proportion of their loans in these sections, the land banks might expose themselves to those hazards which private mortgage companies have been careful to avoid.[21] To the holder of federal farm loan bonds, however, this matter is of little concern because the investment status[22] of these securities is not solely dependent on the ability of the land banks to meet their obligations.

Another device intended to reduce the cost of borrowing was the national farm loan association. Just as the rate of interest

20 It may be that in some sections the outflow of capital is as great as the inflow because it is probable that most of the loans have been made for the purpose of refunding old obligations bearing a higher rate of interest. In analyzing the purpose for which $44,580,035 of the loans were made, the board has found that 63 per cent of the proceeds were used to pay off mortgages; 10 per cent to pay other debts; 10 per cent for buildings and improvements; 8 per cent for the purchase of land; 4 per cent for the purchase of live stock; 3 per cent for the purchase of implements and equipments; and 2 per cent for the purchase of bank stock and for other purposes not specified.

21 It is the contention of every farm mortgage banker whom the writer has consulted that even in the older sections of the country, the federal land banks make a great many loans that no reputable farm mortgage company would consider well secured. There may be some truth in this contention. On the other hand it should be noted that the percentage of loans rejected by the land banks is very large. Up to November 1, 1918, the cancelled and rejected applications for loans amounted to $123,886,120. Further evidence of conservatism is shown in the ruling of the board that land devoted to fruit growing and having no appreciable value for other purposes, cannot be accepted as security for mortgage loans. On this point the practice of some reputable farm mortgage companies has not always been so conservative.

22 It is worth noting that twenty-two states made federal farm loan bonds legal investments for all fiduciary and trust funds before any such bonds had been issued. These states were Arkansas, California, Colorado, Delaware, Florida, Idaho, Maine, Minnesota, Mississippi, Nebraska, New Hampshire, New Jersey, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Utah, West Virginia, and Kansas. In the state of New York the governor declined to recommend to the legislature that such a measure be enacted, and there followed a spirited correspondence on the subject between Governor Whitman and Secretary McAdoo. (*Bulletin of the Farm Mortgage Bankers Association,* vol. IV, April, 1918, p. 14.)

was to be reduced by pledging mortgages as security for bond issues, so it was expected that through coöperative effort borrowers themselves would be able to reduce the administrative charge for loans. The specific machinery created for this purpose was not simple. It was provided that borrowers subscribe 5 per cent of the amount of their loans to the stock of a farm loan association; that the latter subscribe the same amount to the stock of a federal land bank; and that the commission paid by federal land banks to farm loan associations be deducted from dividends on land bank stock. The significance of this arrangement was that commissions would not be paid in advance, and that any portion of the charge not needed to cover expenses would be returned to the borrower in the form of dividends on stock.

It so happens that while the cost of borrowing has been reduced to those farmers who are members of farm loan associations, it has not been reduced in the manner originally contemplated. In fixing the rate of interest on loans at 5 and 5½ per cent when the interest rate on federal farm loan bonds was 4½ and 5 per cent, the administrative charge allowed by the board has been too small to permit the payment of dividends, and it has therefore been impossible for farm loan associations to retain any portion of the commission. Indeed it is difficult to perceive how these associations can ever meet their expenses out of a commission allowed by the federal land banks, when the amount of commission sufficient for that purpose will always be larger than dividends on land bank stock. For the present, however, this technical defect in the law has been overcome by the associations themselves. In some cases funds for current expenses are collected from members by means of assessments. There may be also a membership fee of $2.50 or $5 to be retained by the association whether a loan is made or not. In most associations the borrower contributes one-half per cent of the amount of his loan, or more, when the loan is closed.

The utility of the farm loan association as a principal source of land credit under the new régime is exceedingly doubtful. Even if dividends were paid on the stock of the federal land banks, it is not likely that the borrower would receive dividends on the stock of his association and at the same time be exempt from the payment of assessments. If it is contended that the borrower is relieved of the payment of commissions in advance, it should be noted that he is obliged to subscribe for stock out of his loan when there

is no immediate prospect that any of the subscription will be repaid. This charge alone is equivalent to a flat commission of 5 per cent payable in advance. Furthermore, the interval of time between the application for and the closing of a loan is necessarily long. Time is required not only for the organization of an association but also for the transaction of current business. The process of closing a loan is a complex mechanical operation—especially perplexing to men who have not been accustomed to administering the affairs of credit institutions. While some of the associations have placed themselves in a position to pay for the services of such officers as are needed, this is by no means the rule, and in those cases where salaries are paid they are quite insufficient to command the time and attention of efficient men. Under these conditions the business of the associations is not conducted with the degree of accuracy and dispatch to be found in the business of private firms. It is indeed an open question whether the attempt to economize in the services of efficient middlemen is, after all, sound economy. Finally, there is a distinct tendency on the part of those borrowers who have obtained their loans to lose interest in the loans made to others. This tendency, manifest from the start, is directly opposed to one of the purposes which the act sought to accomplish when it made the farm loan association an integral part of the system, namely, of cultivating the spirit of coöperation among farmers.

It is still too early to pronounce the federal farm loan system either a success or a failure. In the light of its slow progress and meager accomplishments, one would hesitate to call it a distinct success. But its record thus far cannot be made the basis for estimating its future worth. The system is still in the organization stage. If it proves to be unsuccessful, it is not likely to be abandoned but rather to be modified to suit American needs. For the time being, however, it is certain that a much greater measure of success could be assured if coöperation were made entirely voluntary and borrowers were permitted to resort to the method of individual contract in obtaining loans. With most of them the individualistic instinct is deep rooted, and it will require something more than mere legislation to make them coöperative at heart.

George E. Putnam.

Washington University.